This record is a partial extract of the original cable. The full text of the original cable is not available.

C O N F I D E N T I A L SECTION 01 OF 02 MAPUTO 000463

SIPDIS
DEPT FOR AF/S KDAVISON
PLEASE PASS TO OPIC FOR MSHORE
E.O. 12958: DECL: 04/01/2014
TAGS: EINV ETRD PGOV PREL MZ OPIC
SUBJECT: NACALA CORRIDOR PROJECT IN JEOPARDY -- YET AGAIN

Classified By: Econ/Poloff Elizabeth Jaffee for Reasons 1.4 (B) and (D)

¶1. (C) Summary. The Nacala Port and Rail Corridor project is yet again in trouble. Two principal outstanding issues remain: 1) the lack of the government of Malawi (GOM)'s signature on a Direct Agreement and 2) on-going disagreements between the project's US-led consortium and the principal Mozambican government counterpart, Ports and Rails of Mozambique (CFM), over management and personnel matters. The project has reached critical stage. Without a Direct Agreement with Malawi, the project cannot go forward. US shareholders Rail Road Development Corporation (RDC) and Edlow Resources Limited, who have been in Maputo for meetings since March 28, have informed post that the GOM has refused to sign an Direct Agreement based on previously negotiated shareholder terms. The proposed changes to the terms of the Direct Agreement with Malawi would dilute US interests in the project below the threshold set by OPIC and, even if negotiated at a lower level, would require extensive legal revisions to the various agreements already in place. For CFM's part, it continues to play hard-ball over the number of CFM employees to be retained. The lack of transparency in the process has been extremely troubling. RDC and Edlow are trying to be flexible on many of the issues, but their patience is running thin. End Summary.

¶2. (C) Project Background: The Nacala Corridor project dates from 2000, when a concession agreement was signed between CFM and the Nacala Corridor Development Company (SDCN), a consortium comprised of foreign and national investors, creating an autonomous company, Nacala Corridor Development (CDN), for the rehabilitation and modernization of the railroad and port system on a key transport route between Malawi, Zambia and Mozambique. CDN has a highly complicated shareholders structure, with SDCN holding 51% of the shares and CFM holding the remaining 49%. Foreign investors (RDC, Edlow Resources, Manica Limited) hold 67% of SDCN's shares. Private national investors reportedly include the Minister of Transportation, the Secretary General and presidential candidate of ruling party FRELIMO, and several key members of Parliament operating through Mozambican registered companies.

¶3. (C) Malawi Wants Share Of American Interest: On March 31, RDC and Edlow Resources reps met with Malawi's Minister of Transportation Stambuli and members of Malawi's Privatization Commission. A representative of Mozambique's Ministry of Transportation was also present. The GOM representatives are in Maputo as part of President Muluzi's state visit. According to RDC and Edlow, the originally negotiated terms of the Direct Agreement called for 16% of CDN's shares to be provided to a Malawian entity out of CFM's 49% interest. However, during the March 31 meeting, Minister Stambuli stated that Malawi refused to sign the agreement under the previously negotiated terms. Instead, Malawi was now insisting that the US investors sell 33% of its shares in SDCN to the Malawian private firm Farmers World. Minister Stambuli told RDC and Edlow that he needed an answer immediately or the deal was off. RDC and Edlow responded that they did not have the authority to make such a decision and, more importantly, such an arrangement could put the entire project in jeopardy. Specifically, changing the terms of the Direct Agreement in this manner would bring American participation below the percentage required by OPIC and, even if negotiated to a lower number of shares being sold, require legal revisions and reviews of all existing project agreements since it would dramatically alter the shareholding position of the leading (i.e., US) investors. This, in turn, would require renegotiating the OPIC agreement.

¶4. (C) Conversation to Continue in Malawi: Edlow Resources met again with Minister Stambuli on April 1. Stambuli continued to insist on Malawi's shares coming from SDCN. Edlow reminded Stambuli of the previously agreed to terms that the shares would come from CFM and suggested that the GOM speak to CFM over the terms. Edlow has drafted a response to the GOM that, while not rejecting the GOM's proposal, notes that any changes to the shareholding structure would require both SDCN and OPIC approval. Edlow representative Russell Neely will be leaving Maputo for Malawi on April 2 and will contact Embassy Lilongwe regarding a possible meeting with Minister Stambuli.

¶4. (C) Concerns of Malawi Government Representing Private Interests: Further complicating the situation is the role of

a private company, Farmers World, on whose behalf the GOM appears to be negotiating. According to the RDC and Edlow, Farmers World had held discussions with the Mozambican government for the purchase of the 16% equity that was supposed to be reserved for a Malawian interest. Farmers World and the Mozambicans could not agree on a price and, subsequently, it appeared the Mozambican side no longer intended to sell the 16% interest to any Malawian interest. The exact relationship between the Malawian government and Farmers World and why a private company's interests were being raised on behalf of the GOM is unclear. However, RDC and Edlow speculate that the GOM is trying to use Farmers World to somehow increase the government's shares under the Direct Agreement while allowing Mozambique -- through CFM -- to retain 49% of the shares.

¶5. (C) Problems Also With the Mozambicans: Though less of an immediate concern, CFM's complete inflexibility over personnel and management issues continue to place the project in jeopardy even with a Direct Agreement with Malawi. The principal outstanding issues with CFM include the conclusion of a management agreement and the number of CFM employees to be retained. RDC, Edlow and Manica described meetings with CFM on March 29-31 as "difficult" and "tense". CFM has showed characteristic inflexibility. The problem is one largely of CFM's own making. At the end of 2003, CFM tripled current employees' wages thus making retaining more than a limited number of CFM employees economically impossible. CFM also changed the regulations on severance to retrenched workers from the standard 3 months of severance to 6 months. This has put the consortium in an impossible situation. The consortium had originally proposed retaining 30 CFM employees, a number deemed unacceptable by CFM. They have agreed to increase the number, but the issue of retrenchment must further be negotiated. The consortium is providing CFM with a new proposal on personnel and management issues and appears to have been flexible in terms of personnel numbers.

¶6. (C) Prime Minister May Be Helpful: During a pull-aside meeting on March 31 with Prime Minister Diogo at a dinner in honor President Muluzi, the Ambassador urged resolution of the two outstanding issues concerning Mozambique to ensure the project move forward. PM Diogo was not surprised to hear about CFM's objections to the consortium's proposal on the number of CFM personnel to be retained, but seemed genuinely concerned about the CFM's apparent intention not to sell the 16% equity to a Malawian interest. The Prime Minister undertook to get a better handle on CFM's negotiations recognizing the national interest in getting the Nacala Corridor project completed (Note: PM Diogo, in her previous role of Minister of Planning and Finance, appears to be one of the few government officials able to reign in CFM's Director Rui Fonseca)

¶7. (C) Comment: This is not the first time the Nacala Corridor project has been close to collapsing. Numerous delays by the government of Mozambique (GRM) in signing a Direct Agreement required under OPIC regulations in late 2003 almost jeopardized OPIC financing, without which the deal cannot go forward. While it is unclear what role national shareholders and the recent appearance of Farmers World as an interest in the Malawi agreement are playing in preventing the finalization of the project, there is no doubt that Rui Fonseca is actively trying to sabotage the project. There may be genuine concern about the future of CFM's employees. However, it is more likely that Fonseca, an ideological carry-over from Mozambique's socialist past, is most concerned about the loss of his empire, as the Nacala project will be the first privatization of a Mozambican railroad. The only member of the GRM who has appeared willing to confront Fonseca on the issue is Luisa Diogo. Minister of Transportation and Communication Salomao is helpful but has a poor record in overcoming the positions of powerful parastatal directors he ostensibly supervises. Unfortunately, the project has highlighted the difficulties of doing business in Mozambique and the enormous influence that personality and personnel interests continue to play in business deals in Mozambique.
LA LIME